STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF FINANCIAL EXAMINATION

of

**SELECTHEALTH BENEFIT ASSURANCE COMPANY, INC.**

of

Salt Lake City, Utah

as of

December 31, 2006

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October 31, 2007

Honorable D. Kent Michie
Insurance Commissioner
State of Utah
3110 State Office Building
Salt Lake City, UT 84114

Commissioner:

Pursuant to your instructions and in compliance with statutory requirements, an examination, as of December 31, 2006, has been made of the financial condition and business affairs of:

SELECTHEALTH BENEFIT ASSURANCE COMPANY, INC.
Salt Lake City, Utah

hereinafter referred to in this report as the Organization, and the following report of examination is respectfully submitted.

## SCOPE OF EXAMINATION

### Period Covered by Examination

The current examination covers the period from January 1, 2003, through December 31, 2006, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination.

Certificates of representation attesting to the Organization's ownership of all assets and to the nonexistence of unrecorded liabilities were signed by and received from the Organization's management at the conclusion of the examination.

### Examination Procedure Employed

The examination included a general review and analysis of the Organization's operations, the manner in which its business was conducted, and a determination of its financial condition as of December 31, 2006. The examination was conducted under the association plan of the National Association of Insurance Commissioners (NAIC) in accordance with the Financial Condition Examiners Handbook. It also incorporated top-down, risk-focused examination techniques.

The initial phase of the examination focused on evaluating the Organization's governance and control environment, as well as business approach, in order to develop an examination plan tailored to the Organization's individual operating profile. A functional activity approach was determined to be appropriate. The following functional areas were selected for examination: Premium, Benefits and Investments.

The examination determined the inherent risks associated with each of the functional areas and assessed the residual risk for each of the areas after considering the mitigating factors. Mitigating factors considered were corporate governance and control environment in addition to work performed by external and internal audit functions. Interviews were held with the senior management of the Organization to gain an understanding of the entity's operating profile and control environment. Based on the assessment of residual risk examination procedures were reduced where considered appropriate.

Status of Prior Examination Findings

The previous examination was performed by the Utah Insurance Department (the Department) as of December 31, 2002. Items of significance noted in the prior examination report summary were as follows:

- The Organization was not in compliance with Utah Code Annotated (U.C.A.) §31A-20-108 as to the limit of risk it was allowed to retain.

Items of significance noted in the report generated by the previous examination were appropriately addressed during the current examination unless otherwise noted in the "Summary" section of this report.

## HISTORY

General

In 1975, the Church of Jesus Christ of Latter-day Saints transferred all assets and liabilities of its hospital system to a Board of Trustees. The Board of Trustees in turn created Intermountain Health Care, Inc. (IHC) a nonprofit corporation, to own and operate the hospital system. In 1982, IHC Hospitals, Inc., subsequently named IHC Health Services, Inc., was established as a subsidiary of IHC for the purpose of operating the hospital holdings.

IHC incorporated IHC Health Plans, Inc. (HPI), under the provisions of the Utah Nonprofit Corporation and Cooperative Association Act, on December 27, 1983, for the purpose of developing and administering financial mechanisms for its network of health care services. HPI began operations as a nonprofit preferred provider organization and became licensed as an HMO on December 6, 1985. HPI formed and became the sole controlling member of IHC Care, Inc. (Care), a non-profit HMO in 1985 and IHC Group, Inc. (Group), a non-profit HMO in 1991, which were later merged into HPI in 2000. In 1992, HPI formed a wholly owned for-profit life insurance company, IHC Benefit Assurance Company, Inc. (the Organization). In 2006 the Organization changed its name to SelectHealth Benefit Assurance Company, Inc. and HPI changed its name to SelectHealth, Inc. (SelectHealth).

Capital Stock

As amended, the Articles of Incorporation provide the Organization with 50,000 shares of $375 par value common stock. At December 31, 2006, the Organization had issued and outstanding 2,000 shares of capital stock totaling $750,000, and gross paid in and contributed surplus totaling $1,250,000. There were no changes to capitalization during the period under review.

The Organization is 100% owned by SelectHealth, a non-profit HMO domiciled in the state of Utah. The ultimate controlling entity is Intermountain Health Care, Inc.

Dividends to Stockholder and Others

There were no dividends declared or paid by the Organization during the period under review.

Management

The Organization's Amended Bylaws state that the number of Board of Trustees shall not be less than four or more than thirty persons, as determined from time to time by the stockholders.

The following persons served as Board of Trustees of the Organization as of December 31, 2006:

| Name | Principal Occupation |
|---|---|
| Sydney C. Paulson | President/CEO-SelectHeatlh |
| Teresa Beck | Retired |
| James A. Dunnigan | Producer-Dunnigan Insurance |
| Daniel E. England | CEO-C. R. England |
| Gladys L. Gonzalez | President-Hispanic Marketing and Consulting |
| Nancy M. Heuston | President/Founder-The Waterford School |
| Kevin J. Jensen | VP-Professional Management Group |
| Edward G. Kleyn | President-Wells Fargo Northern UT & Southwest WY |
| Diane T. Naylor | VP-Naylor Insurance Agency |
| William H. Nelson | President - Intermountain Health Care |
| Bradford R. Rich | CFO/Treasurer-Sky West Airlines, Inc. |
| Stephen D. Taylor | Physician - Wasatch Emergency Physicians |

| | |
|---|---|
| Stephen W. Wade | President/Owner-Stephen Wade Auto Centers and Stephen Wade Power Sports |
| Thomas B. Morgan | Executive VP-Zions First National Bank |
| H. Don Norton | President/CEO-Far West Bank |

The officers of the Organization as of December 31, 2006, were as follows:

| Principal Officer | Office |
|---|---|
| Sydney C. Paulson | President/Chief Executive Officer |
| Lisa K. Fallert | Secretary/Vice President |
| Todd D. Trettin | Treasurer/Vice President/CFO |
| Stephen L. Barlow | Vice President |
| David H. Olson | Vice President |
| Jerry R. Edgington | Vice President |
| J. Murphy Winfield | Vice President |

The members of the Organization's Audit Committee as of December 31, 2006, were as follows:

Audit Committee Members

Teresa Beck, Chair
H. Don Norton
Bradford R. Rich

The members of the Organization's Finance Committee as of December 31, 2006, were as follows:

Finance Committee Members

Teresa Beck, Chair
H. Don Norton
Bradford R. Rich
Sidney C. Paulson
Todd D. Trettin

The members of the Organization's Executive Committee as of December 31, 2006, were as follows:

Executive Committee Members

Thomas B. Morgan, Chair
Teresa Beck
Daniel E. England
Sidney C. Paulson

## Conflict of Interest Procedure

The Organization maintains a formal conflict of interest policy that provides that no employee will engage in outside business activities that will create a conflict of interest with the work and mission of the Organization. No trustee, director, officer or employee may use their position or any knowledge gained as a result of their position in any manner such that a conflict does or may arise between the Organization's interest and those of the individual. The policy applies to all employees of the Organization.

Conflict of Interest Statements disclosing any potential conflicts are filled out annually by the employees including the Board of Trustees and officers. Statements are reviewed by management and the human resources department for any material conflicts. No material conflicts were noted during the period under review.

## Corporate Records

The Organization's Articles of Incorporation were amended on March 31, 2006, primarily to change the name of the Organization to SelectHealth Benefit Assurance Company, Inc., and to revise the provision related to the Board of Trustees. The amended Articles were filed with and approved by the Department. The bylaws were last amended and restated as of June 15, 2006. The amended bylaws were provided to the Department for review.

The last meeting of the Board of Trustees during the examination period was held on October 20, 2006, and the board approved the minutes of that meeting on March 22, 2007. The Department examination report as of December 31, 2002, dated January 5, 2004, was distributed to the board on June 12, 2004, in compliance with U.C.A. § 31A-2-204(8).

## Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance

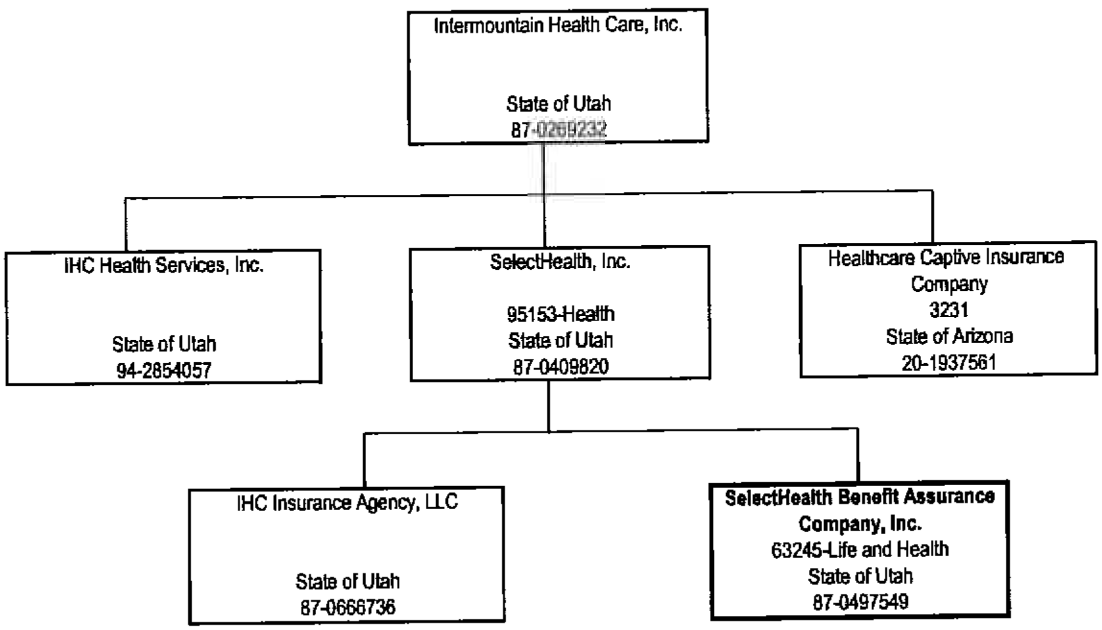
There were no acquisitions, mergers, disposals, dissolutions, or purchases/sales through reinsurance during the period under review.

## Surplus Debentures

There are no surplus debentures outstanding as of the examination date.

## AFFILIATED COMPANIES

The Organization is a member of an insurance holding company system, with IHC being the ultimate controlling entity. Following is an abbreviated organizational chart derived from the Annual Statement, Schedule Y as of December 31, 2006:




IHC is a Utah nonprofit charitable corporation which, through its affiliated companies, provides health care and related services to communities and individuals in the intermountain region. IHC Health Services, Inc. (IHCHS) is a Utah nonprofit corporation that provides medical and administrative services to the Organization. SelectHealth is a nonprofit HMO. IHC Insurance Agency, LLC acts as an agency for the Organization.

## Transactions with Affiliates

The Organization is a party to an Administrative Services Agreement with IHCHS. Under the agreement the Organization and IHCHS each may provide to the other various services, including management, payroll processing, investment management, retirement, human resources, insurance coverage, legal, facilities, information systems and telecommunication services. Services are provided at their fair value, with "fair value" defined in accordance with usual accounting standards and practices.

The Organization receives marketing and administrative services under the terms of an Administrative Services Agreement with SelectHealth. The Agreement was effective July 1, 1994, and automatically renews each January 1 for a calendar year period. The Agreement relates to the Point of Service option (non-emergency, out-of-panel encounters) which is insured by the Organization and is offered in conjunction with certain of SelectHealth's policies. Premium is calculated in accordance with the formula contained within the agreement, and is remitted by SelectHealth monthly. The Agreement also provides for an experience rating refund to be calculated. At the end of five months following each year end a final calculation is determined and 99% of the resulting surplus as calculated is remitted from the Organization to SelectHealth. If the experience rating refund is determined to be negative, the amount is then carried forward into the following period.

IHC, through a resolution of its Board of Trustees, was noted to have committed to provide to SelectHealth, and indirectly to the Organization, loan guarantees or financing sufficient to enable these companies to meet all of its financial obligations and commitments.

A review of the Organization's 2006 Consolidated Form B filing, as filed on April 30, 2007, indicated that the filing was not in compliance with U.C.A. § 31A-16-105. The filing did not disclose several of the affiliated transactions, including the Administrative Agreement with IHCHS, the surplus distribution, declared by SelectHealth and SelectHealth's TPA agreement to administer the IHC employees' self insured plan. The Organization filed an amended Form B filing with the Department on October 31, 2007.

## FIDELITY BOND AND OTHER INSURANCE

As of the examination date, the Organization participated in fidelity bond coverage of $5,000,000 under a Commercial Crime Insurance Policy issued to IHC, its subsidiaries and affiliates. The amount of coverage was equal to the maximum limits suggested by the NAIC

The Organization was also a participant on various other IHC insurance policies, including property, general liability, workers compensation policies and directors and officers liability insurance.

## PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Organization does not have any employees, and as such is not covered under any Pension, Stock Ownership, and Insurance Plans.

## STATUTORY DEPOSITS

The Organization's statutory deposit requirement was $400,000 pursuant to U.C.A. § 31A-5-211(2). The examination confirmed the Organization maintained a statutory deposit consisting of a Federal Home Loan Bond with a par value of $500,000, which was adequate to cover the required deposit.

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Policy Forms and Underwriting

The Organization's forms used for advertising materials and for the group policyholder files were compared against the record of filed forms at the Department. No discrepancies were noted.

The Organization retained all risks other than losses incurred at hospitals. In general, the Organization's risk retention for losses incurred at hospitals was the first $1,000,000 of loss or losses incurred at an IHC hospital or the first $500,000 of loss or losses incurred at other hospitals by each covered person during an agreement year, plus 10% of losses in excess of the initial retention. The Organization issued policies with limits up to $2,500,000.

### Territory and Plan of Operation

The Organization was authorized to conduct Life and Health business solely in the state of Utah. The Organization wrote a Point of Service coverage offered in conjunction with certain policies offered by its parent, SelectHealth. All related administration is performed by SelectHealth under the terms of a written agreement. The SelectHealth policies are offered through large employer group, small employer group, and individual policies in Utah. Dental coverage, also offered as an option under the SelectHealth policies, is also provided by the Organization. Excess Loss policies are also issued by the Organization to clients to whom SelectHealth acts as a TPA.

The Organization contracted with Guarantee Trust Life Insurance Company (GTL) to offer a new product known as NationCare. This product makes available a Preferred Provider Organization network of providers for out-of-state employees related to Utah employers. GTL is the insurer for the out-of-state employees and the Organization covers excess losses from $100,000 to $350,000 on the out-of-state employees. GTL entered into a reinsurance agreement with an unaffiliated entity to cover losses per claimant in excess of $350,000 per year.

The Organization marketed its products through SelectHealth using independent producers appointed by an affiliated insurance agency, IHC Insurance Agency, LLC, and through approximately 110 unaffiliated insurance agencies appointed by the Organization. The producers received a commission based on the policy premium.

Certain agencies were also eligible to receive a override commission based upon the volume of business produced.

The agencies work closely with the Organization's in-house sales force to deliver products to the clients.

U.C.A. § 31A-20-108 does not permit an insurance company to expose itself to loss on any single risk in an amount exceeding 10% of its capital and surplus. At December 31, 2006, the Organization was limited (after considering authorized reinsurance) under this statute to a maximum of $565,163. Although no actual instances of losses exceeding the maximum amount were found, it was noted that in those situations where the Organization provided services at a covered hospital, it was possible that the Organization was exposing itself to a $1 million risk. It was also noted that although the Organization reduced the policy limits in 2007 to $1 million, under the circumstances noted above the Organization could still be overexposed.

On October 22, 2007, SelectHealth delivered a request (Form D filing) to the Department to transfer an additional $5 million to the Organization. The proposed transfer is sufficient to bring the Organization into compliance with the statutory requirements. The transfer was not disapproved by the Department on October 23, 2007. The Organization received the $5 million surplus contribution from SelectHealth on October 31, 2007.

### Advertising and Sales Material

Sales materials were reviewed in a concurrent market conduct examination. The materials included packets given to potential clients and materials given to employees after enrollment into health plans. No material exceptions were noted.

### Treatment of Policyholders

The Organization shares with its parent, SelectHealth, written grievance procedures with its policyholders. The formal process for appealing an adverse benefit determination of a pre-service claim provided one mandatory review level, two possible voluntary review levels and the right to pursue civil action. The formal process for appealing an adverse benefit determination of a post-service claim provided two mandatory review levels, one voluntary review level, and the right to pursue civil action.

## REINSURANCE

As of the examination date, an excess loss reinsurance agreement with Munich American Reassurance Company was in effect. The Organization's initial retention was the first $1,000,000 of loss incurred at an IHC hospital or the first $500,000 of loss incurred at other hospitals by each covered person during the agreement year.

Reinsurance reimbursable amounts were based on the percentages shown below that were in excess of the initial retention:

- 90% of eligible losses, after certain reinsurance limitations, for transplant services performed in a hospital in which the reinsurer or the Organization had negotiated arrangements. The Organization's arrangements were required to be approved by the reinsurer.
- 50% for eligible losses, after certain reinsurance limitations, for transplant services performed in a hospital with which neither the reinsurer nor the Organization had negotiated arrangements and/or the Organization's arrangements were not approved by the reinsurer.
- 90% of eligible losses for services other than transplant services, after certain reinsurance limitations, for services performed in a hospital.

The maximum reinsurance indemnity payable under the agreement was calculated on the basis of $2,000,000 of coverage for each covered person per agreement year.

## ACCOUNTS AND RECORDS

The Organization's general ledger is an in-house developed system located on an IBM iSeries and is maintained and administered by IHCHS. Premium and claims transactions are automatically fed to the general ledger through the primary policy and claims administrative system, FACETS. This system was installed by the Organization during this examination period.

An independent certified public accounting firm, KPMG LLP audited the Organization's records for the years ended 2004, 2005 and 2006. The previous year, 2003, was audited by Ernst & Young LLP. Audit reports generated by these auditors were made available for the examiner's use.

Although licensed as a Life and Health insurer, the Organization files its Annual Statement on the "Health" blank. Such filing is required pursuant to the *Annual Statement Instructions* when a reporting entity is licensed as a Life and Health insurer but passes the Health Statement Test, as provided in the instructions.

During the examination period, the Organization was not in compliance with Utah Administrative Code (U.A.C) Rule R590-178-5 related to the provisions contained in the executed custodial agreements. The Organization made the necessary changes during the course of the examination and although compliance is no longer an issue, we recommend that the Organization establish a process by which changes to the U.A.C. are monitored to ensure compliance.

## FINANCIAL STATEMENTS

The following financial statements were prepared from the Organization's accounting records and the valuations and determination made during the examination:

BALANCE SHEET as of December 31, 2006

STATEMENT OF REVENUE AND EXPENSES for the Year Ended December 31, 2006

RECONCILIATION OF CAPITAL AND SURPLUS – 2003 through 2006

The accompanying NOTES TO FINANCIAL STATEMENTS are an integral part of the financial statements.

SelectHealth Benefit Assurance Company, Inc.
BALANCE SHEET
as of December 31, 2006

ASSETS

| | Net Admitted Assets | Notes |
|---|---|---|
| Bonds | $ 7,570,853 | |
| Cash and short-term investments | 2,937,859 | |
| Investment income due and accrued | 84,366 | |
| Current federal income tax | 195,000 | |
| Net deferred tax asset | 79,000 | |
| Receivables from parent, subsidiaries and affiliates | 252,124 | |
| Total assets | $ 11,119,202 | |

LIABILITIES, SURPLUS, AND OTHER FUNDS

| | | |
|---|---|---|
| Claims unpaid | $ 2,950,000 | |
| Unpaid claims adjustment expenses | 83,000 | |
| Aggregate health policy reserves | 1,670,699 | |
| Amounts due to parent, subsidiaries and affiliates | 162,828 | |
| Total liabilities | 4,866,527 | |
| Common capital stock | 750,000 | |
| Gross paid in and contributed surplus | 1,250,000 | |
| Unassigned funds (surplus) | 4,252,675 | |
| Total capital and surplus | 6,252,675 | (1) |
| Total liabilities, capital and surplus | $ 11,119,202 | |

SelectHealth Benefit Assurance Company, Inc.
STATEMENT OF REVENUE AND EXPENSES
for the Year Ended December 31, 2006

| | Total | Notes |
|---|---|---|
| Net premium income | $ 14,651,496 | |
| Change in unearned premium reserves | (999,170) | |
| Total revenues | 13,652,326 | |
| Hospital and Medical: | | |
| Hospital/medical benefits | 7,115,138 | |
| Other professional services | 3,325,042 | |
| Emergency room and out-of-area | 211,095 | |
| Medical supplies | 205,418 | |
| Subtotal | 10,856,693 | |
| Less: | | |
| Net reinsurance recoveries | 0 | |
| Total hospital and medical | 10,856,693 | |
| Claims adjustment expenses | 909,125 | |
| General administrative expenses | 1,321,705 | |
| Total underwriting deductions | 13,087,523 | |
| Net underwriting gain or (loss) | 564,803 | |
| Net investment income earned | 346,938 | |
| Net investment gains or (losses) | 346,938 | |
| Miscellaneous income | - | |
| Net income or (loss) before federal income taxes | 911,741 | |
| Federal and foreign income taxes incurred | 324,700 | |
| Net income (loss) | $ 587,041 | |

SelectHealth Benefit Assurance Company, Inc.
RECONCILIATION OF CAPITAL AND SURPLUS
2003 through 2006

| | 2003 | 2004 | 2005 | Per Exam 2006 | Notes |
|---|---|---|---|---|---|
| Capital and surplus prior reporting year | $ 4,616,025 | $ 4,925,156 | $ 5,129,696 | $ 5,651,631 | |
| Net income or (loss) | 374,131 | 133,540 | 522,935 | 587,041 | |
| Change in unrealized gains and (losses) | (9,000) | 21,000 | 4,000 | | |
| Change in deferred income tax | (56,000) | 50,000 | (5,000) | 14,000 | |
| Rounding | | | | 3 | |
| Net change in capital and surplus | 309,131 | 204,540 | 521,935 | 601,044 | |
| Capital and surplus end of reporting year | $ 4,925,156 | $ 5,129,696 | $ 5,651,631 | $ 6,252,675 | |

Per the regulatory financial statements filed with the Utah Insurance Department.

## NOTES TO FINANCIAL STATEMENTS

(1) Capital and surplus $6,252,675

The Organization's capital and surplus was determined to be equal to the amount reported in the Organization's annual statement as of December 31, 2006.

The Organization's minimum capital requirement was $400,000 as defined in U.C.A. § 31A-5-211(2)(a). As defined by U.C.A. § 31A-17 Part 6, the Organization had total adjusted capital of $6,252,675, which exceeded the company action level risk-based capital (RBC) requirement of $1,885,454 by $4,367,221.

SUMMARY OF EXAMINATION FINDINGS

Items of significance commented on in this report are summarized below:

- A review of the Organization's 2006 Consolidated Form B filing, as filed on April 30, 2007, indicated that the filing was not in compliance with U.C.A. § 31A-16-105. The filing did not disclose several of the affiliated transactions, including the Administrative Agreement with IHCHS, the surplus distribution declared by SelectHealth, and SelectHealth's TPA agreement to administer the IHC employees' self insured plan. The Organization filed an amended Form B filing with the Department on October 31, 2007. (AFFILIATED COMPANIES - Transactions with Affiliates)

- U.C.A. 31A-20-108 does not permit an insurance company to expose itself to loss on any single risk in an amount exceeding 10% of its capital and surplus. At December 31, 2006, the Organization was limited (after considering authorized reinsurance) under this statute to a maximum of $565,163. Although no actual instances of losses exceeding the maximum amount were found, it was noted that in those situations where the insured was provided services at a covered hospital, it was possible that the Organization was exposing itself to a $1 million risk. (INSURANCE PRODUCTS AND RELATED PRACTICES - Territory and Plan of Operation).

  On October 22, 2007, SelectHealth delivered a request (Form D filing) to the Department to transfer an additional $5 million to the Organization. The proposed transfer is sufficient to bring the Organization into compliance with the statutory requirements. The transfer was not disapproved by the Department on October 23, 2007. The Organization received the $5 million surplus contribution from SelectHealth on October 31, 2007.

- During the examination period, the Organization was not in compliance with U.A.C Rule R590-178-5 related to the provisions contained in the executed custodial agreements. The Organization made the necessary changes during the course of the examination and although compliance is no longer an issue, we recommend that the Organization establish a process by which changes to the U.A.C. are monitored to ensure compliance. (ACCOUNTS AND RECORDS)

Organization into compliance with the statutory requirements. The transfer was not disapproved by the Utah Insurance Department of October 23, 2007. The Organization received the $5 million surplus contribution from its parent on October 31, 2007.

## ACKNOWLEDGEMENT

Frank G. Edwards, Jr., ASA, MAAA, of the actuarial firm of INS Consultants, Inc. performed the actuarial phases of the examination. In addition, Mary L. Rodack, CFE, Malis Rasmussen, and Moli Abejar participated in the examination representing the Utah Insurance Department. Colette M. Hogan, CFE, CPM, supervised the examination. They join the undersigned in acknowledging the assistance and cooperation extended during the course of the examination by officers, employees, and representatives of the Organization.

Respectfully Submitted,

Robert J. Rodack

Robert J. Rodack, CFE
Utah Insurance Department